Nos. 645, 646

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JAMES Q. NEWTON TRUST

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JAMES Q. NEWTON, JR.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT

THE W. H. KISTLER STAT'Y CO., DENVER

INDEX

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (No. 645, R. 12–18; No. 646, R. 22–29) is reported in 42 B. T. A. 473. The opinion of the Circuit Court of Appeals (No. 645, R. 44; No. 646, R. 47–48) is reported in 122 F. (2d) 416.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered July 24, 1941. (No. 645, R. 44-45; No. 646, R. 48). The petition for writs of certiorari was filed on September 23, 1941. Following denial on February 9, 1942, a petition for rehearing was filed on February 28, 1942, and the petition was granted on March 9, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayers exchanged their first mortgage bonds for new income bonds and common stock of a new company pursuant to a plan of reorganization under Section 77B of the Bankruptcy Act. The question is whether gain was recognized for income tax purposes upon this exchange. The answer depends upon (1) whether the exchange was tax-free under Section 112 (b)(5) of the Revenue Act of 1936; or (2) whether the plan of reorganization under 77B was a "reorganization" within the definition of Section 112 (g)(1) so that the exchange was tax-free under Section 112 (b)(3).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 32-39.

STATEMENT

These cases involve precisely the same facts, except for the different taxpayers and amounts involved, as *Helvering v. Cement Investors, Inc.*, No. 644. The facts have been stated in the Government's brief in the *Cement Investors* case and the bulk of the Government's argument in this case, except for one point re-

lied upon by the taxpayers here, has been advanced in its brief in that case and has not been repeated in its brief filed in the instant cases. It is therefore necessary to refer to the Government's brief in both the *Cement Investors* cases and these cases.

Since Exhibits D through N, both inclusive, of the record in these cases are identical with the corresponding exhibits in the *Cement Investors* case, it has been agreed that these exhibits need not be reprinted. (No. 645, R. 197). It is therefore necessary to refer to the record in the *Cement Investors* case for these exhibits.

There is agreement as to the facts. The statement of the case by the Government (No. 644 Pet's Br. pp. 2–6) is a fair summary of the essential facts except as to the amounts involved. In the reorganization, the James Q. Newton Trust surrendered $152,000 face amount of Colorado Industrial Company first mortgage 5% bonds due August 1, 1934, in exchange for $60,800 principal amount of income mortgage bonds and 3,040 shares of common stock of the new company. James Q. Newton, Jr., surrendered $10,000 principal amount of the bonds for $4,000 principal amount of the new bonds and 200 shares of stock.

SUMMARY OF ARGUMENT

1. This case involves an exchange of securities. It does not involve the determination of the basis of transferred assets. It does not involve, except secondarily, the problem of whether there was a reorganization. It is a case of whether gain or loss was recognized for income tax purposes on the exchange by the taxpayers of their old bonds for new bonds and stock of the new company. The provisions of Section 112 (b) (5)[1] apply

[1] Revenue Act of 1936, C. 690, 49 Stat. 1648; Sec. 112 (b) (5).

precisely to the facts and under that Section no finding of a reorganization is necessary. The exchange of securities by the taxpayers was tax-free under that section.

There is no conflict or inconsistency between the decision in the *Southwest Consolidated Corporation* case[2] and the application of Section 112 (b) (5) here. That section did not apply to the *Southwest* case. The correlative disposition of basis cases and recognition cases is not affected by the application of Section 112 (b) (5) here.

The taxpayers transferred their bonds, which were valuable property rights, to the new company in exchange for all the new securities, pursuant to the plan of reorganization under Section 77B[3]. The exchange of the old securities for new and the transfer of the legal title to the physical assets by the old company to the new one were separate phases of the reorganization plan as a whole. The transfer of the bonds was the valuable consideration for the issuance of the new securities in exchange therefor. The bonds evidenced the full priority rights of the bondholders in the physical assets. That was the reason why the new securities were issued to the bondholders and to no one else.

The bondholders were also the transferors of the physical assets. The conveyance was made by their agents and representatives, on their behalf, and for their benefit. It was the carrying out of the legal formalities necessary to make the bondholders the complete legal owners of the assets. They were the owners

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[2] Decided February 2, 1942; 86 L. Ed. 512.

[3] Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as added by Act of June 7, 1934, c. 424, 48 Stat. 911: Sec. 77B (U. S. C. Title 11, Sec. 207).

of the assets, which could not have been transferred by anyone else.

2. The transaction was also a statutory consolidation within the definition of Clause A of Section 112 (g) (1) and, therefore, no gain or loss was recognized thereon under Section 112 (b) (3). The two old corporations consolidated; they merged their identity into a new corporation pursuant to the provisions of a plan of reorganization under Section 77B. The definition in Clause A does not require that a merger or consolidation be effected under the statute creating corporate life in order to be "statutory". Section 77B is, and was intended by Congress to be, a statute within the definition so that mergers or consolidations effected under it are "statutory".

ARGUMENT

Introductory—The Circuit Court held for the taxpayers on the two grounds that (1) there was a reorganization under Section 112 (g) (1) C and (2) there was a non-taxable exchange under Section 112 (b) (5). (122 Fed. (2d) 380). The decision in the *Southwest Consolidated* case (supra) established that the definition in Clause C of Section 112 (g) (1) does not apply here since, although the bondholders had stepped into the shoes of the old stockholders and had acquired their proprietary interest in the insolvent company, they had not become "stockholders" within the strict wording of Clause C. Accordingly, the Respondents do not urge the applicability of Clause C.

Granted that the consistent treatment of the correlative issues of basis on the one hand and recognition of gain or loss on the exchange of securities on the other, was intended and is desirable, the alleged in-

consistent treatment of the two issues in this case and in the *Southwest Consolidated* decision does not exist. The alleged confusion on the basis issue is not caused by the application of Section 112 (b) (5) to the facts here, but by the failure of the Commissioner to recognize that the old basis may be carried over under Section 112 (b) (5) *notwithstanding* there is no reorganization.

I

THE TRANSACTION WAS A NON-TAXABLE EXCHANGE WITHIN THE MEANING OF SECTION 112 (b) (5).

Section 112 (b) (5) applies literally to the facts. Under Section 112 (b) (5):

(1) Property.

(2) Must be transferred to a corporation by one or more persons.

(3) Solely in exchange for stock or securities of such corporation.

(4) Immediately after the exchange, such person or persons must be in "control" of the corporation.

(5) But in case of an exchange by two or more persons, the amount of the stock and securities received by each must be substantially in proportion to his interest in the property prior to the exchange.

Detailed analysis of the transaction in terms of the provisions of this Statute show the presence of every element necessary to come within its strictest terms:

(1) *Property.* The property transferred was the bonds owned by the taxpayers. Bonds are "securities"

within the meaning of that term in the Revenue Act. (*Helvering v. Watts*, 296 U. S. 387; 56 Sup. Ct. 275; 80 L. Ed. 289.). Securities are property. Intangible property as well as physical property may be the property transferred under Section 112 (b) (5).[4] In many of the cases where Section 112 (b) (5) has been held applicable, the "property" transferred has been bonds or stocks. *Commissioner v. Newberry Lumber and Charcoal Co.*, 6th Circ. 94 Fed. 2nd, 447; *Frederick L. Leckie v. Commissioner*, 37 B. T. A. 252; *Von's Investment Co., Ltd. v. Commissioner*, C. C. A. 9th; 92 Fed. 2nd 861 (1937).

The Commissioner has also disregarded a long line of cases in arguing that the section does not apply to an exchange of securities. The property transferred may be stock, *The Griswold Co.*, 33 B. T. A., 537; it may be defaulted bonds, *Frederick L. Leckie*, 37 B. T. A. 252; it may be creditors claims in an insolvent corporation, *Rockford Brick and Tile Co.*, 31 B. T. A. 537; it may be other securities, *Commissioner v. Freund*, (C. C. A. 3) 98 Fed. 2nd 201, 21 A. F. T. R. 181; it may include money, *Portland Oil Company v. Commissioner*, 109 F (2d) 479 (C. C. A. 1st), certiorari denied, 310 U. S. 650. *George P. Skouras v. Commissioner*, 45 B. T. A. No. 159 (notes); *Louis W. Gunby Inc. v. Helvering*, 122 Fed. (2d) 203 (C. C. A. D. C.) (1941) (securities).

(2) *Property was transferred to a corporation by one or more persons.* The Taxpayers surrendered their Industrial bonds to the distributing agents in exchange for the new securities. (No. 644, R 168-170). The distributing agents may not have actually deliv-

[4] See Regulations 94, Article 112 (b) (5) (1), Example 2, (patent right).

ered these bonds to the new corporation so that it in turn might deliver them to the indenture trustee for cancellation. But it is wholly immaterial whether they delivered the bonds to the new company, so that it could in turn surrender them to the indenture trustee, or themselves delivered the bonds to the indenture trustee. Whichever method was actually used, the bonds were surrendered for cancellation and the mortgage was released in order that the physical assets which had been transferred to the new company could be freed of the lien of the mortgage. If the bonds were surrendered to the distributing agents rather than to the new company, it was for the purpose of simplifying the transaction and the bonds were received by the distributing agents on behalf of the new company and for its benefit. The distributing agents had no beneficial interest in the old securities or the new securities and were merely a conduit for the convenience of all the parties concerned. (No. 644, R. 138-140.)

Since the distributing agents received all the stock of the new company and, pursuant to direction of the court, voted the stock in favor of the creation of the new income mortgage, (No. 644 R. 123, 127) it is quite clear that they held the old bonds for the benefit of the new company which could not create the new mortgage until the old lien had been wiped off the assets. Had anything intervened to interrupt the transaction, each step of which had to be carried out "simultaneously" (No. 644 R. 133-136) the paramount rights of the bondholders would have been asserted and they would have established their claim to the property (bonds) transferred to the new company or its agents.

(3) *Property was transferred to a corporation solely in exchange for stock or securities in such corpora-*

tion. The term "stock or securities" includes stock *and* securities. Regulations 94, Article 112 (g) (2). The bondholders received income mortgage bonds and common stock of the new corporation and nothing else. There was no "boot" received; all the securities presently issued (except the warrants) were issued to the old bondholders. (No. 645 R. 11; No. 644 R. 70.) The government apparently admits this and there is no argument as to the application of this part of the statute.

(4) *Immediately after the exchange, the transferors were in control of the corporation.* The bondholders received all the stock of the new corporation. No stock was issued in the reorganization to anyone else. Therefore, there was one hundred per cent "control" of the new corporation immediately after the exchange as that term is defined in Section 112 (h) of the Revenue Act of 1936. There is apparently no dispute on this point.

(5) *The securities received by each transferor were in proportion to his interest in the property prior to the exchange.* Under the plan of reorganization, each Industrial bondholder was treated exactly alike. Nonassenting bondholders who did not accept the plan (who represented less than 25% of the outstanding bonds) were bound by its terms (Sec. 77B; 11 U. S. C. Sec. 207 (b) (9)). Under the plan each bondholder received exactly the same amount of income mortgage bonds and common stock for each old bond held by him. Consequently, the amount of new securities received by each old bondholder was not merely "substantially" but exactly "in proportion to his interest in the property prior to the exchange." This point is not in dispute.

The proportionate interest requirement is satisfied not only with respect to the Respondents and other old bondholders similarly situated, but also from the point of view of all security holders of the old companies. The express purpose of Section 77B is to determine the true equity ownership of the property of the debtors involved according to the equities of each class of security holder. Each security holder of the two old companies who was affected by the plan surrendered his securities in exchange for new securities in the new company and the stock or securities received by him were *exactly* proportionate to his interest in the property prior to the exchange. In other words, the proceeding under Section 77B was an actual adjudication of the respective interests of all the security holders in the properties transferred to the new company.

Under the revenue laws, words should be given their ordinary and usual meaning unless there is some definite reason to the contrary. (*Von Weise, et al. v. Commissioner,* 69 Fed. 2d 439). Section 112 (b) (5) according to its strict terms and the decided cases applies both literally and in its essential purpose to the facts of this case. The embarrassment which it has caused the Commissioner in his efforts to collect a tax here is evident in the arguments he has advanced to meet it.

The most important argument advanced by the Commissioner is that a decision here in favor of the taxpayer based on Section 112 (b) (5) will conflict with the decision of this court in the *Southwest Consolidated* case, *(supra)*. The contention is that Section 112 (b) (5) cannot be applied to this case because if it is and the exchange is tax free, then the old asset basis will carry over under Section 113 (a) (8) and that will be

inconsistent with the *Southwest Consolidated* case, because there, on similar facts, a new basis was established. There are two answers to this alleged inconsistency: First, the fact that the exchange is tax free under Section 112 (b) (5), does not make this a reorganization contrary to the *Southwest Consolidated* doctrine since there need be no reorganization under Section 112 (b) (5). Second, if 112 (b) (5) applies to the *Southwest Consolidated* case, then it was wrongly decided and the exchange should have been tax free and the old basis for the assets should have been carried over to the transferee.

Respondents agree that if Section 112 (b) (5) applied to the facts of the *Southwest Consolidated* case, then the alleged inconsistency between the decision of this Court there and the decision of the Circuit Court here, as the Commissioner argues, would exist. But Section 112 (b) (5) does not apply to the facts of the *Southwest Consolidated* case. In the first place, the property transferred to the new corporation by the bondholders committee in that case was not transferred "solely in exchange for stock or securities" within Section 112 (b) (5). As this Court pointed out in the *Southwest* case, "solely" means just that. The property was actually transferred for securities *and* cash which was raised by a bank loan and was used to pay off non-participating security holders who owned obligations in the face amount of $440,000.00. In substance, it was the same as though the transferee had paid cash and stock for the properties. In the second place, as this Court clearly pointed out in its opinion in the *Southwest* case:

> "The rights of the security holders against the old corporation were drastically altered by the

sale made pursuant to the plan." (86 L. Ed. p. 515.)

This alteration of the rights of various classes of creditors and security holders is entirely inconsistent with Section 112 (b) (5).

Plainly, the alleged inconsistency between the *Southwest Consolidated* case and this case does not exist. The facts of the *Southwest* case do not fit any of the tests of reorganization defined in Section 112 (g) (1) for various reasons fully discussed by this Court. They also fail to fit the test of Section 112 (b) (5). There are no broad principles by which these questions can be decided. Each case depends upon its own particular facts. The Court found a reorganization in the *Alabama Asphaltic Limestone* case,[5] because the facts there fitted the definition in Section 112 (i) (1) A under the 1928 Act. The Court likewise found a reorganization in the *Palm Springs Holding Corporation* case[6] under the 1932 Act for similar reasons. The Court found no reorganization within the statutory definition in the *Bondholders Committee (Marlborough House)* case,[7] because none of the definitions of reorganization applied to the facts nor did Section 112 (b) (5) apply to those facts. Likewise, the facts in the *Southwest* case did not fit any of the definitions in the 1934 Act and obviously did not fit the requirements of Section 112 (b) (5).

There is a reorganization or a tax free exchange wherever the Statute applies and there is none where the Statute does not apply. Section 112 (b) (5) fits the facts of this case, but does not fit the facts of the

[5] Decided February 2, 1942; 86 L. Ed. 504.
[6] Decided February 2, 1942; 86 L. Ed. 507.
[7] Decided February 2, 1942; 86 L. Ed. p. 509.

Southwest Consolidated case. There is no inconsistency. Nothing in the Commissioner's lengthy argument concerning the "synchronization" of the taxing statutes, or the importance of "uniformity" has any direct bearing on these facts.

For these reasons the government's argument with respect to the "correlative disposition" of basis questions under Section 113 and recognition questions under Section 112, falls to the ground. The reorganization and exchange provisions and the basis provisions are correlative. But the Commissioner refuses to recognize the hard fact that it is not necessary for there to be a reorganization under Section 112 (b) (3) for a corporation to retain its old basis. The basis provisions of Section 113 do not apply *solely* to reorganizations under Section 112 (b) (3). They also apply to other tax-free transfers. Section 113 (a) (8) applies expressly to exchanges under Section 112 (b) (5). (Appendix page 35.) That section is just as important a part of Section 112 as is Section 112 (b) (3). One does not override the other, nor is the application of Section 112 (b) (5) made in any sense "doubtful" simply because Section 112 (b) (3) does not apply.

The essential fact is that under Section 113 the old basis may be carried over in the hands of the transferee if there has been a reorganization *or* if there has been a tax-free exchange under Section 112 (b) (5). It may be emphatically clear, as it was in the *Southwest Consolidated* case, that there was no reorganization on any ground; still, there may be a tax-free exchange and the old basis may carry over if Section 112 (b) (5) applies. The argument developed by the Commissioner, reduced to its simplest terms, is that Section 112 (b) (3) and 112 (b) (5) are in fundamental con-

flict because under the former no reorganization may be found and a new basis will result whereas on the same facts Section 112 (b) (5) may apply and the old basis will carry over. The obvious answer is that both sections are complementary and if *either* applies, the old basis is carried over under Section 113.[8]

The other argument advanced by the Commissioner is that the "property" transferred in exchange for the securities was the physical assets, not the bonds, and that the bondholders may not be considered the transferors of the physical assets received by the new company. The contention is that the bondholders had nothing to do with the transfer of assets which was made by the indenture trustee, the reorganization managers and the old corporations. It is said that they were the transferors. (Br. pp. 15-17; 28.)

It is the Respondent's position that the "property" transferred to the new company by the bondholders in exchange for the new securities was the bonds. But if the property transferred be considered the physical assets, those assets also were actually transferred by the bondholders. To deny this is to ignore the realities of the transaction.

Under the doctrine of the *Alabama Asphaltic Limestone Company* case and the *New Haven and Shore-*

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[8] The legislative history of Section 112 (b) (5) lends no support to the Commissioner's theory that that section cannot apply where there is no reorganization. On the contrary, the section has been retained unchanged since the Revenue Act of 1928 (Section 112 (b) (5); 45 Stat. 791) and originated in Section 202 (b) of the Revenue Act of 1918 (40 Stat. 1057) in order that no gain or loss should be deemed to occur "when a person or persons owning property receive in exchange for such property stock of a corporation formed to take over such property." The exemption was clearly independent of, although developed concurrently with, the reorganization provisions. See: Report—Senate Finance Committee (65th Cong., 3d Sess., S. Rept. 617) and Report—Conference Committee (65th Cong., 3d Sess., H. Rept. 1037) in Seidman's *Legislative History of Federal Income Tax Laws* (1938) pp. 899.

line Railroad case *(supra)*, the bondholders had stepped into the shoes of the old stockholders and had "effective command over the disposition of the property." Their "full priority" rights in those assets under the *Boyd* and *Los Angeles Lumber Company* cases[9] were paramount. They were as much the owners of the assets before the transfer as after. The transfer "did nothing but recognize officially what had been true in fact." The old corporations were mere shells. They had nothing left but their corporate existence. Their joinder in the conveyance was a mere formality because they had nothing left to convey, nothing to transfer. The rights of the indenture trustee and the reorganization managers in respect of the assets were merely those of an agent or trustee for the bondholders holding the legal title. The transfer of the physical assets was made by the agents of the bondholders for the sole benefit and account of the bondholders and on their behalf. The transfer of the rights of ownership in those assets, and the only value given for the new securities, was when the bondholders surrendered the bonds evidencing those rights or the account of the new company. If some persons other than the bondholders transferred those assets to the new company then the new securities, issued in exchange therefor, should have been issued to those persons and not to the bondholders.

Clearly, if the bondholders had bid in the property at a sale, as in the *New Haven and Shore Line Railroad* case 121 F. (2d) 985, and then turned around and conveyed the property to the new company in exchange for its securities, there would be no question as to their hav-

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[9] *Northern P. R. Co. v. Boyd*, 228 U. S. 482; *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106.

ing transferred the property. In the old days, before Section 77B, this is what would have been done. Section 77B removed the necessity of this step. Under Section 77B the power to bind a dissenting minority to the terms of the plan obviates the need of cash payment to those security holders who do not want to participate in the plan and removes the necessity for the costly and cumbersome procedure of foreclosure and sale. It would have been "a peculiarly fatuous formality" to have required the assets to pass through the bondholders to the new company. Surely, the fact that this old and cumbersome procedure was not necessary under the provisions of Section 77B does not mean that the bondholders were any less the transferors of the assets than as if the old procedure had been followed. Clearly the whole force behind the transfer of the assets was the bondholders, who were carrying out "the prescribed legal formalities necessary to make themselves the complete legal owners of the property." L. Hand, J. in *New Haven and Shore Line Railroad Co. v. Commissioner*, 121 Fed. (2d) 985, 987.

The substance of the transaction and not its form should determine the applicability of the taxing statute. (*Gregory v. Helvering*, 293 U. S. 465, 469.) If the value of the securities owned by these taxpayers when they were exchanged had been less than their cost and the taxpayers had sought to establish a loss, the Commissioner would have rightly insisted that substance and not form should control and that the exchange was tax-free under Section 112 (b) (5). Thus, in a number of cases, the courts have disregarded form and applied Section 112 (b) (5) in support of the Commissioner's contention that substance should control. (*Gunby, Inc. v. Helvering*, 122 Fed. (2d) 203; *Labrot v.*

Burnet, Commissioner, 57 Fed. (2d) 413; *Snowden v. McCabe*, 111 Fed. (2d) 743; *Kuldell v. Commissioner*, 97 Fed. (2d) 725.) Here, in order to circumvent the precise application of Section 112 (b) (5), the Commissioner has been constrained to argue (Br. p. 20-21) that the transfer involved two phases: the transfer of the corporate assets and the exchange of securities, notwithstanding the established rule that the transaction must be considered as a whole and should not be "atomized" into separate steps. (*Helvering v. Southwest Consolidated Corp., supra*). Surely the heart of this entire transaction was the transfer by the bondholders to the new company of their debt and the rights, evidenced by their bonds, in exchange for the new securities.

Finally, the argument is advanced that the bondholders transferred nothing, that they merely surrendered their old claims for cancellation, and that to come within Section 112 (b) (5) the property transferred must continue as property in the hands of the transferee. It is said that the property interest in the old securities was terminated and never passed in a situation analogous to the redemption and satisfaction of a bond or the compromise and settlement of a note (Br. pp. 21-22). But the facts are not so and the cases cited do not apply. The bonds were not surrendered to the maker and satisfied in exchange for the collateral security as in *Commissioner v. Spreckels*, 120 Fed. (2d), 517, *Commissioner v. National Bank of Commerce*, 112 Fed. (2d), 946, and *Bingham v. Commissioner*, 105 Fed. (2d) 971. There was no compromise of the debt at less than face value as in *Hale v. Helvering*, 85 Fed. (2d) 819. The assets were not transferred by the debtor companies to the mortgagee-bondholders. The bonds

were not surrendered up for cancellation and extinguishment by the bondholders to the debtors. The bonds were not redeemed, paid, compromised or settled; they were *exchanged.*

The important distinction to be made between those cases and the instant case is that here the bondholders did not receive payment of their debts but exchanged their debts for a continuing interest in the new corporation. *Miller and Paine v. Commissioner of Internal Revenue*, 42 B. T. A. 586, 593 (1940) (On appeal to 8th Circuit Court of Appeals).[10]

The difficulty with this theory is illustrated by the fact that it is hard to describe this transaction without using the word "exchange." (Pet's Br., pp. 16-17). There was no termination of old rights and creation of new. There was an exchange of property. The old bonds were securities which evidenced certain property rights in the assets by virtue of the debt and the terms of the indenture. When the rights of the bondholders changed and became paramount, (*Alabama Asphaltic Limestone Company* case, *supra*) the bonds, although physically the same securities, acquired new rights:

[10] This case is an interesting illustration of a situation where, presumably for "administratixe" purposes and to protect the revenues (Br. No. 644 p. 26), the argument of the Commissioner was the direct opposite of that advanced here. In the *Miller and Paine* case the taxpayer exchanged his bonds and stock in a financially embarrassed corporation for new stock in a new company. The taxpayer claimed a bad debt deduction on the authority of the *Bingham* case *(supra)* and *Hale v. Helvering (supra).* The Board of Tax Appeals sustained the Commissioner's position that Section 112 (b) (5) applied saying: "In the instant case there can be no question but that the creditors . . . transferred their *notes* to the New York corporation and received in exchange therefor solely stock in the New York corporation. *In other words, they did not receive payment of their debts, but exchanged their debts for a continuing interest in the new corporation.* This is the sort of transaction where no gain or loss is recognized, provided the conditions required by Section 112 (b) (5) of the Revenue Act of 1934 are met." (42 B. T. A. 593) (Italics supplied). The Commissioner evidently takes either side of this argument depending in each case upon "whose ox is gored."

the right to step into the place of the old stockholders; the right of full dominion over the assets; and the right to dispose of the property subject to the court's control. These rights were valuable property rights and they had a market value. When they were transferred to the new company, all its securities were issued in exchange for them; they were the *value* given for those securities. Everything depended upon the transfer of those rights of the bondholders. Without that, the physical assets could not have been transferred to the new company, the new mortgage could not have been created, the old mortgage could not have been released, and the new securities could neither have been created nor issued.

II

THE TRANSACTION CONSTITUTED A "STATUTORY MERGER OR CONSOLIDATION" WITHIN THE MEANING OF CLAUSE A, SECTION 112 (g) (1) OF THE REVENUE ACT OF 1936.

(1) Before both the Board of Tax Appeals and the Circuit Court, the Commissioner argued vigorously that there could be no reorganization here because the necessary continuity of interest was lacking. Presumably, the decisions of this court in the *Alabama Asphaltic Limestone Co.* case *(supra)* and the *Southwest Consolidated Corp.* case have silenced this contention. Upon the authority of those decisions and the denial of certiorari in *Helvering v. New Haven & S. L. R. Co.* (Feb. 9, 1942) it is submitted that this issue is no longer open to argument. Quite clearly, if there was continuity of interest under the Revenue Act of 1928 in the *Alabama Asphaltic* case, and there would have been the same in the *Southwest Consolidated* case under the law, (86 L. Ed., p. 514) there would likewise be con-

tinuity of interest under the Revenue Act of 1928 in this case. By inference this court admitted as much when it said in the *Southwest Consolidated* case:

> "The contrary conclusion was reached in Commissioner of Internal Revenue v. Cement Investors (C. C. A. 10th) 122 Fed. (2d) 380, 384, on the theory that the bondholders of the insolvent predecessor company could be regarded as its 'stockholders' within the meaning of § 112 (g) (1) (C), since they had acquired an equitable interest in the property and were empowered to supplant the stockholders. We have adopted that theory in Helvering v. Alabama Asphaltic Limestone Co., — U. S. —, ante, 504, 62 S. Ct. —, supra, in determining whether the bondholders had retained a sufficient continuity in interest so as to bring the transaction within the statutory definition of merger or consolidation contained in the revenue acts prior to 1934."

Furthermore, it is evident that the transaction here would have been considered a "consolidation" within the meaning of that term in the revenue acts prior to 1934. The *Pinellas Ice & Cold Storage Co.* case (287 U. S. 462) established that in the revenue acts prior to 1934, the terms "merger or consolidation" included transactions "beyond the ordinary and commonly accepted meaning of those words." And the *Alabama Asphaltic Limestone* case *(supra)*, established that "Insolvency reorganizations are within the family of financial readjustments embraced in those terms as used in this particular statute." (86 L. Ed., p. 506.)

Under the definition prior to the 1934 amendments there was clearly a consolidation here. The fact that

the word "consolidation" was not used in describing the plan, and the fact that the Court did not direct articles of consolidation to be filed under the Colorado Statute—these do not mean that the transaction was something other than a consolidation. As the definitions in the *Pinellas* case and in *Cortland Specialty Co. v. Commissioner* (60 F. (2d) 937) show[11] it is impossible to define a consolidation without describing precisely what happened in this case. Thus, all the assets of the two companies, the Industrial company and the Fuel company, were conveyed to the new company; the new company continued to carry on the business of the two old companies; all the securities and stock of the old companies with a minor exception were cancelled and the new company assumed the liabilities of the two old companies. In other words, the two old companies were consolidated into a new company which was created by direction of the court, and the consolidating corporations were extinguished.

(2) Granted that there would have been a consolidation of the two old companies into the new within the definition under the Revenue Act of 1928, the problem is the effect of the amendments of the definition in the Act of 1934 which admittedly were designed to restrict its scope. (Paul, *Studies in Federal Taxation* (3rd Series) pp. 36, et seq.) The Revenue Act of 1934 amended the definition of clause A by adding the word "*statutory.*"[12] The meaning of this amendment was un-

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[11] "In a merger one corporation absorbs the other and remains in existence while the other is dissolved. In a consolidation a new corporation is created and the consolidating corporations are extinguished." (57 Fed. (2d) 188, 190.)

"A consolidation involves a dissolution of the companies consolidated and a transfer of corporate existence and franchises to a new company." (60 Fed. (2d) 937, 939.)

See also: *Von Weise v. Commissioner*, 69 F. (2d) 439, 442.

[12] Cf. Revenue Act, 1928, Section 112 (i) (1) (A) and Revenue Act, 1934, Section 112 (g) (1) A.

certain. It was not clear what the word "statutory" was intended to include. This uncertainty was illustrated by the fact that the Regulations first published[13] were later amended to read as follows:

> "The words 'statutory merger or consolidation' refer to a merger or consolidation effected in pursuance of the corporation laws *of the United States* or a state or territory or the District of Columbia. (Italics supplied.)

In the earlier version of the regulations, the italicized words were omitted. This amendment was effected by Treasury Decision 4585 (XIV—2 Cum. Bull. 54—1935). Article 112 (g) (2) of Regulations 86 under the Revenue Act of 1934 were retained unchanged in Regulations 94, under the Revenue Act of 1936.

The amendment of the Regulations by Treasury Decision 4585, *supra*, emphasized the fact that the Treasury understood the term "statutory merger or consolidation" was meant to include mergers or consolidations carried out under federal statutes as well as the state corporation statutes and it was generally understood to have that effect.[14]

(3) The intent of Congress in adopting the amendments in the Revenue Act of 1934 was two fold. At the hearings a strong plea had been made by a subcommittee of the Ways & Means Committee of the House[15] for the total elimination of the reorganization provisions from the statute. But the fact that the

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[13] Regulations 86, Article 112 (g) (2).

[14] See Paul and Mertens, *Law of Federal Income Taxation*, Vol. 2, Section 17.70, page 162 and footnote 99. See also Fahey: *Income Tax Definition of Reorganization*, 39 Columbia Law Review 933, 960, (1939).

[15] Report Ways & Means Subcommittee (73d Cong., 2d Sess., H. Rept., Dec. 4, 1933).

country was in the depths of financial depression and that elimination of the provisions would permit taxpayers to take large losses, thus drastically shrinking the revenues, led the Committee to change its mind. It determined, first, to limit the reorganization provisions so that legitimate reorganizations might be permitted; and, second, to reduce tax avoidance by restricting the provisions so that "astute lawyers" could not "take advantage of these provisions by arranging in the technical form of a reorganization, within the statutory definition, what were really sales."[16]

(4) As an example of the type of "legitimate reorganizations required in order to strengthen the financial condition of the corporation," which the new reorganization provisions were designed to permit, the House report *supra* mentions the following:

> "A few examples will bring out the reasons for the action of the committee. Thus, as a result of the *Emergency Banking Act*, a number of banks have found it necessary to strengthen

[16] Report—Ways and Means Committee, 73rd Cong., 2d Sess., H. Rept. 704:

> "The committee proposes to limit the application of the reorganization provisions by two principal changes. . . . In the second place, the definition of a reorganization has been restricted so that the definition will conform more closely to the general requirements of corporation law, and will limit reorganizations to (1) statutory mergers and consolidations; (2) transfers to a controlled corporation, 'control' being defined as an 80-percent ownership; and (3) changes in the capital structure or form of organization.
>
> "By these limitations the committee believes that it has *removed the danger that taxable sales can be cast into the form of a reorganization*, while at the same time, *legitimate reorganizations, required in order to strengthen the financial condition of the corporation, will be permitted.* Furthermore, the retention of the other reorganization provisions will prevent large losses from being established by bondholders and stockholders who receive securities in a newly reorganized enterprise which are substantially the same as their original investments.

See also: Report—Senate Finance Committee, 73rd Cong., 2d Sess., S. Rept. 558 (pp. 16-17).

their condition by merging or consolidating. These mergers have materially aided the banking situation in these various communities. The provisions of the bill will enable these plans to be carried out without the recognition of gain or loss for income tax purposes, whereas if the provisions were omitted entirely, the participating shareholders would be entitled to large losses for tax purposes. Likewise, many corporations have defaulted upon the dividends on their cumulative preferred stock, or upon the interest on their bonds. These corporations, in order to obtain necessary credit from the banks, are arranging with their preferred stockholders to accept new common stock, and with their bondholders to accept noncumulative preferred stock in place of preferred stock or bonds now held. If the reorganization provisions were omitted from the bill, these stockholders and bondholders could take large losses, although they still retain an interest in the corporation." (Report—Ways & Means Committee (73d Cong., 2d Sess., H. Rept. 704, pp. 13-14). (Italics supplied.)

The Emergency Banking Act,[17] the correct name of which is the "Bank Conservation Act," was passed at a time of nation-wide financial panic when the country's banking structure was on the verge of collapse. It was emergency legislation designed to meet emergency needs. Section 207 of that act established a new method for the reorganization of banks in financial difficulties. It is quoted in the Appendix p. 38. Under the old consolidation statute (12 U. S. C. §§ 33, 34, 34(a)) an

[17] March 9, 1933, c. 1, Tit. II, § 201, 48 Stat. 2; 12 U. S. C. § 201-213; Appendix p. 38.

elaborate system was set forth whereby, upon the merger or consolidation of two national banks, or a national and state bank, the shares of non-assenting shareholders could be appraised by three appraisers and approved by the Comptroller of the Currency and if the value so appraised was not satisfactory the shares could ultimately be sold at public auction. (See 12 U. S. C. § 33.) The new law superseded this statute and set up a new and radically different arrangement for reorganizing banks. It provided that if certain percentages of the creditors, depositors or stockholders agreed to a plan which the Comptroller of the Currency was satisfied was "fair and equitable," the non-assenting stockholders, creditors and depositors were fully bound and subject to the provisions of the plan and were treated as if they had consented to it. It was a new concept. It superseded the old law.

The mention of the Emergency Banking Act in the committee reports *(supra)* shows that Congress considered that statute a typical reorganization statute which it intended should be included within the revised definition of reorganization in the Revenue Act of 1934. Congress clearly contemplated that mergers and consolidations effected under the provisions of that law should be considered "statutory" and tax-free.

Section 77B of the Bankruptcy Act is very similar in its underlying purpose and method to the Emergency Banking Act. It did for ordinary business corporations what the Bank Conservation Act did for banks. The novelty of Section 77B was that upon submission to the federal court having jurisdiction of a plan which appeared to be "fair and equitable" to all classes of security holders, and upon approval of the plan by the necessary percentages of interested persons,

the plan would become binding upon the non-assenting minority to the same extent as if they had agreed to it. Like the Emergency Banking Act, Section 77B created a new, simplified procedure for reorganizing corporations in financial difficulties and hundreds of corporations availed themselves of its provisions.

Although the Emergency Banking Act applied to the reorganization of national banks which derive their corporate powers from the federal government under the National Bank Act,[18] the act itself was an exercise of the bankruptcy power of the government under the constitution. (*Miller v. National Chautauqua County Bank*, 240 App. Div. 169; 270 N. Y. S. 522). The exercise of this bankruptcy power superseded the consolidation provisions of the statute affecting national banks; it overrode the rights of the minority stockholder formerly protected by section 33 of the National Bank Act. It no longer mattered what the charter or the law *creating* the bank provided in this respect; it was superseded by the new reorganization provisions under the bankruptcy power.

Similarly under Section 77B (App. p. 35) the bankruptcy power supersedes state laws and grants to the court having jurisdiction the right to consolidate "the properties of the debtor with those of another corporation" or to direct "the merger or consolidation of the debtor into or with another corporation or corporations." (App. p. 36.) Once the state-chartered corporation becomes insolvent or bankrupt and the federal bankruptcy court acquires jurisdiction over the property of the debtor, the bankruptcy power is paramount and exclusive. What authority or jurisdiction granted

[18] 12 U. S. C. § 21 et seq.

the original charter creating the corporation becomes unimportant.

(5) The Commissioner argues (Br. 5-7) that the term "statutory merger or consolidation" should be construed to mean: *merged or consolidated under the law creating the corporation.* The Respondents contend that the term should be construed (in order to effectuate the undoubted intent of Congress) to mean: *deriving the power to merge or consolidate from a statute.*

The narrow construction of the term urged by the Commissioner has little to recommend it. The expressed intent of Congress was to permit *bona fide* reorganizations required to strengthen the financial condition of corporations to have the benefit of the reorganization provisions. If Congress intended the word "statutory" to apply only to those mergers or consolidations effected under the law creating the corporation, why did it use as an example of a "statutory reorganization" one effected under the Bank Conservation Act, which was not the same law of the United States which created the banks which were consolidated or merged under it? If Congress intended the phrase to apply to consolidations under that law, it must be presumed to have intended the same result under an analogous law—Section 77B.

There are many federal laws authorizing mergers and consolidations. They include laws authorizing the consolidation of common carriers (49 U. S. C. § 5), the consolidation of telephone companies (47 U. S. C. § 221), the consolidation of state banks with national banks (12 U. S. C. § 34(a)) and others.[19] Mergers or con-

[19] See Fahey: 39 Columbia Law Rev., 933, 946.

solidations under all of these laws must be "statutory."[29] Thus, under the Interstate Commerce Act, a consolidation of two common carriers may be ordered by the Interstate Commerce Commission. The power to consolidate is vested in the Commission under the act. Surely the fact that the carriers involved derive their charter from state law does not mean that the consolidation is any less "statutory" than it would be if carried out under the state law. The state law is superseded. It has no power over the subject matter.

Congress cannot have intended the phrase "statutory merger or consolidation" to apply to some federal statutes and not others. It clearly intended the word to include mergers or consolidations carried out under the provisions of any statute, state or federal. The obvious intent was to allow *bona fide* reorganizations carried out due to business exigencies under the provisions of statutes, whether the Bank Conservation Act mentioned in the Committee Reports, or Section 77B of the Bankruptcy Act, or other similar statutes.

(6) The position of the Commissioner that 77B reorganizations are not "statutory" brings about wholly arbitrary and absurd results. Section 77B is probably the most famous reorganization statute ever enacted. Under the Commissioner's contention, however, mergers or consolidations effected under this statute require the recognition of gain or loss, whereas those effected under state laws permit non-recognition. Thus, in large bankruptcies and reorganizations, where large losses are usually sustained and non-recognition

[29] The Interstate Commerce Commission (under § 5, Title 49, U. S. C.), determines the legality and desirability of proposed consolidations of common carriers. It may then "enter an order approving and authorizing such consolidation, merger, . . . or acquisition of control, upon the terms and conditions and with the modifications so found to be just and reasonable."

of gain or loss is really desirable in order to prevent losses of revenue to the Treasury, the Commissioner's position requires recognition; but if there is the saving grace of technical compliance with the merger and consolidation laws of any state or territory, (however clumsy and inadequate the provisions of those laws may be to effect their purpose), then the tax benefits of being "statutory" arise. This is directly contrary to the intent of Congress and is precisely what it was seeking to prevent.[21]

No state statute contains provisions for the elimination of stock interests or the readjustment of corporate structure possible under the bankruptcy powers of the Federal Government.

It would have been futile to attempt a consolidation here under the Colorado Statute. The persons in control of the situation and having full priority power were the bondholders, and nothing could be done without their consent no matter what the stockholders may have wanted to do or how large a percentage of them approved the articles of consolidation. The charters of the old corporations were merely tools in the hands of the bankruptcy court to be used or discarded as the circumstances warranted.

(7) The consolidation of the Industrial company and the Fuel company into the new company was certainly statutory in the sense that it was consummated pursuant to the provisions of Section 77B. The whole transaction was carried out and effected by the Federal District Court under its authority and jurisdiction under 77B. The Federal District Judge for the District

[21] Statement of the Acting Secretary of the Treasury regarding the preliminary report of a sub-committee of the Committee on Ways & Means, 73d Cong., 2d Sess., p. 10.

of Colorado, who authorized and directed the reorganization in the instant case, thus described the transaction in a subsequent opinion, briefly summarizing the history of the reorganization:

> "In due course, a plan of reorganization was filed, a pertinent provision of which called for the organization of a new company, The Colorado Fuel & Iron Corporation . . . The New Company was accordingly *organized under the supervision of the Court, which prescribed the terms of the certificate of incorporation, by-laws and all other steps necessary to complete its organization.* Its Articles of Incorporation state it was to take over and operate the business of the Colorado Fuel & Iron Company, then in reorganization . . .
>
> "The New Company, a creature of the court, was under its care until July 1, 1936 . . . .
>
> "I believe in the point I made at the argument, i.e., that the plaintiff was an arm or creature of the court previous to June 30, 1936, and not subject to the tax. Sec. 77B, Art. X, Sec. 216, says a plan of reorganization may provide that *the court, in the execution of a plan, may create and use one or more other corporations organized or thereafter to be organized and may, in effect, dictate the charter of such new corporation . . .*" (*The Colorado Fuel & Iron Corporation v. Nicholas*, 28 Fed. Supp. 449, 450.)

The Commissioner's position is that if the Court had chosen to direct the two companies to file articles of consolidation under the Colorado Statute, the transaction here would have been a statutory reorganization. But because the Court organized a new company

and directed the transfer of the old company's assets to it, the Commissioner contends that the transaction was not "statutory" and must be taxed. Surely this Court will not endorse a theory so inconsistent with the Congressional intent or so at variance with the essential nature of the transaction itself.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted,

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April, 1942

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*— * * *

* * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the

acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however, effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

Sec. 113 [as amended by Section 807 of the Revenue Act of 1938, c. 289, 52 Stat. 447].

Adjusted basis for determining gain or loss.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(6) Tax-free exchanges generally.—If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis (except as provided in paragraph (15) of this subsection) shall be

the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

(7) Transfers to corporation.—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or

securities of the transferee as the consideration in whole or in part for the transfer.

(8) PROPERTY ACQUIRED BY ISSUANCE OF STOCK OR AS PAID-IN SURPLUS.—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

*   *   *   *   *

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as added by Act of June 7, 1934, c. 424, 48 Stat. 911:

SEC. 77B. CORPORATE REORGANIZATIONS.—* * *

(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character or otherwise; * * * (9) shall provide adequate means for the execution of the plan, which may include the transfer of all or any part of the property of the debtor to another corporation or to other corporations, or the consolidation of the properties of the debtor with those of another corpora-

tion, or the merger or consolidation of the debtor into or with another corporation or corporations, or the retention of the property by the debtor, the distribution of assets among creditors or any class thereof, the satisfaction or modification of liens, indentures, or other similar instruments, the curing or waiver of defaults, extension of maturity dates of outstanding securities, the change in interest rates and other terms of such securities, the amendment of the charter of the debtor, and the issuance of securities of either the debtor or any such corporation or corporations, for cash, or in exchange for existing securities, or in satisfaction of claims or rights, or for other appropriate purposes; (10) may deal with all or any part of the property of the debtor and may include any other appropriate provisions not inconsistent with this section. * * *

* * * * *

(h) Upon final confirmation of the plan, the debtor and other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative thereto, under and subject to the supervision and control of the judge, and the property dealt with by the plan, when transferred and conveyed by the trustee or trustees to the debtor or the other corporation or corporations provided for by the plan, or, if no trustee has been appointed, when retained by the debtor pursuant to the plan or transferred by it to the other corporation or corporations provided for by the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, and the court may direct the trustee or trustees, or if there be no trustee, the debtor and any mortgagee, the trustee of any obligation of the debtor, and all other proper

and necessary parties, to make any such transfer or conveyance, and may direct the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, if any, making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. Such final decree shall discharge the debtor from its debts and liabilities, and shall terminate and end all rights and interests of its stockholders, except as provided in the plan or as may be reserved as aforesaid. * * * (U. S. C., Title 11, Sec. 207.)

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 112 (b) (5)-1. *Transfer of property to corporation controlled by transferor.*—As used in section 112 (b) (5), the phrase "one or more persons" includes individuals, trusts or estates, partnerships and corporations (see section 1001); and to be in "control" of the transferee corporation such person or persons must own immediately after the transfer at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation. (See section 112 (h).) The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

Example 1: A owns certain real estate which cost him \$50,000 in 1920, but which has a fair market value of \$150,000 in 1936. He transfers this property to the M Corporation, a newly formed company, for all the latter's capital stock. No gain or loss is recognized from the transaction.

Example 2: C owns a patent right worth $25,000 and D owns a manufacturing plant, worth $75,000. C and D organize the R corporation with an authorized capital stock of $100,000. C transfers his patent right to the R Corporation for $25,000 of its stock and D transfers his plant to the new corporation for $75,000 of its stock. No gain or loss to C or D is recognized.

Example 3: B owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $200,000 in 1936. He transfers the property to the N Corporation in 1936 for 78 percent of all classes of stock of the corporation, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1933 to other persons for cash. B realizes a taxable gain of $150,000 on this transaction. (See section 112 (h).)

Bank Conservation Act. (March 9, 1933, c. 1, Tit. II, paragraph 201, 48 Stat. 2. * * *

SECTION 207. REORGANIZATION OF BANKS.—In any reorganization of any bank under a plan of a kind which, under existing law, requires the consent, as the case may be, (a) of depositors and other creditors or (b) of stockholders or (c) of both depositors and other creditors and stockholders, such reorganization shall become effective only (1) when the Comptroller of the Currency shall be satisfied that the plan or reorganization is fair and equitable as to all depositors, other creditors and stockholders and is in the public interest and shall have approved the plan subject to such conditions, restrictions and limitations as he may prescribe and (2) when, after reasonable notice of such reorganization, as the case may require, (A) depositors and other creditors of such bank representing at least 75 per cent in amount of its total deposits and other liabilities as shown by the books of the bank or (B) stockholders owning at least two-thirds of

> its outstanding capital stock as shown by the books of the bank or (C) both depositors and other creditors representing at least 75 per cent in amount of the total deposits and other liabilities and stockholders owning at least two-thirds of its outstanding capital stock as shown by the books of the bank, shall have consented in writing to the plan of reorganization: . . . In any reorganization which shall have been approved and shall become effective as provided herein, all depositors and other creditors and stockholders of such bank, whether or not they shall have consented to such plan of reorganization, shall be fully and in all respects subject to and bound by its provisions, and claims of all depositors and other creditors shall be treated as if they had consented to such plan of reorganization.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 112 (g)-2. *Definition of terms.*—The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 112 (g) (1). * * *
>
> The words "statutory merger or consolidation" refer to a merger or a consolidation effected in pursuance of the corporation laws of the United States or a State or Territory or the District of Columbia.